

No. 92-1384

Supreme Court, U.S.

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In The
Supreme Court of the United States
October Term, 1993

BARCLAYS BANK PLC,

Petitioner,

v.

FRANCHISE TAX BOARD,
An Agency of the State of California,

Respondent.

On Petition For A Writ Of Certiorari
To The Court Of Appeal Of The State Of California
In And For The Third Appellate District

SUPPLEMENTAL BRIEF OF RESPONDENT
FRANCHISE TAX BOARD IN OPPOSITION TO
PETITION FOR WRIT OF CERTIORARI

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Pursuant to Rule 15.7, respondent Franchise Tax Board files this supplemental brief to its brief in opposition to taxpayer's petition for writ of certiorari to inform this Court of legislation recently enacted by the State of California which modifies the elective water's-edge combined report method originally adopted by California in 1986 (Stats. 1986, chapter 660) and applicable to income years beginning on or after January 1, 1988. The earlier water's-edge legislation was discussed at page 6 of the

Franchise Tax Board's opposition brief and at footnote 1 (pp. 2-3) of petitioner's reply brief.

STATUTORY PROVISIONS

Appendix A to this supplemental brief in response contains excerpts from chapter 881 of the 1993 California statutes, which was signed into law by the Governor of the State of California on October 6, 1993.

ADDENDUM TO THE SUPPLEMENTAL STATEMENT OF THE CASE

On October 6, 1993, the Governor of the State of California signed into law Senate Bill 671 (Alquist), which became chapter 881 of this year's California laws. Sections 13, 16, and 22 through 26 of chapter 881 modify the operations of water's-edge combined report accounting method election originally added to California law in 1986, operative beginning January 1, 1988. Those sections of the 1993 chaptered bill are included in Appendix A to this brief. Section 34 provides that those modifications are operative beginning January 1, 1994.

California originally enacted the water's-edge combined report accounting election as a result of discussions held under the aegis of the Worldwide Unitary Taxation Working Group, which was formed at the request of President Ronald Reagan in 1983. The 1986 enactment of

the California legislation prompted senior Treasury officials to retreat from their previous insistence that Congress prohibit state use of worldwide formula apportionment. Petition Appendix C, pp. C-36 to C-37.

During the pendency of this petition the United Kingdom has threatened to implement (Letter of Ian Spence, Director International Division, Inland Revenue, Tax Notes Today, 93 TNT 124-23, June 11, 1993) retaliatory legislation against United States based companies if a "satisfactory resolution" were not found to the question of unitary taxation before the end of 1993.

The United Kingdom and the European Economic Community apparently had three major concerns with the California water's-edge combined report election as first enacted in 1986. First, they objected to the retained ability of the Franchise Tax Board to require taxpayers to use the worldwide combined report method under certain circumstances. Second, they objected to the conditioning of the right to elect upon the payment of a fee. And third, they objected to the reporting requirements imposed by the "Domestic Disclosure Spreadsheet."

The amendments to California law make three major changes in the operation of the water's-edge combined report accounting method. These changes are:

1. Removal of current section 25111(c) of the California Revenue and Taxation Code, which provided the California Franchise Tax Board with the authority to disregard a water's-edge election in three specified circumstances. See Section 23.

In place of the ability to disregard a water's-edge election, the legislation provides the Franchise Tax Board with additional authority to impose monetary penalties in aid of its audit efforts and provides it with broad authority to redetermine income if the requested information is not provided. Section 16. The provisions of this section are modeled after 26 U.S.C. section 6038A.

2. Amendment of California Revenue and Taxation Code section 25115, effective for income years beginning on or after January 1, 1984, to eliminate the requirement that any election fee be paid to make the water's-edge election. Section 26.

3. Replacement of the "Domestic Disclosure Spreadsheet" with an "information return" which identifies the corporate parent and those affiliates of which more than 20 percent of the voting stock is directly or indirectly controlled by the parent corporation. Section 13.

On September 14, 1993, subsequent to the legislative passage of this legislation, the Chancellor of the Exchequer of the United Kingdom, the Rt. Hon. Kenneth Clarke QC MP, addressed a letter to the United States Secretary of the Treasury, Hon. Lloyd Bentson. This letter contained the United Kingdom government's official reaction to the California Legislation. While noting that the United Kingdom still supports the taxpayer petitioner in the *Barclays* case, the letter officially acknowledges that, as a result of the California legislation, the United Kingdom will defer the implementation of any retaliatory measures. 1993 Tax Analysts State Tax Notes, 93 STN 181-16 (September 20, 1993).

CONCLUSION

For the reasons given in respondent Franchise Tax Board's brief in opposition to the petition, and in light of the additional facts presented above, it is respectfully submitted that the petition for writ of certiorari should be denied.

Dated: October 8, 1993.

Respectfully submitted,

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APPENDIX A
CALIFORNIA STATUTES
1993-94 REGULAR SESSION
CHAPTER 881
SENATE BILL NO. 671

The people of the State of California do enact as follows:

. . . .

SEC. 13. Section 18634 of the Revenue and Taxation Code, as added by Chapter 31 of the Statutes of 1993, is amended to read:

18634. (a) Any taxpayer determining its income subject to tax pursuant to Section 25101 or making the election under Section 25110 shall file with the Franchise Tax Board within six months after the due date (including extensions) of the bank's or corporation's California return required under this part an information return if it and its related banks' or corporations' total assets exceed two hundred million dollars (\$ 200,000,000), or such higher levels as may be subsequently established by regulation.

(b) The information return shall be filed once every three years, unless there is a substantial change in the taxpayer's business activities, in which case it shall be filed for the year in which the change occurs.

(c) For purposes of this section, banks and corporations are related if more than 50 percent of the voting stock of one is directly or indirectly owned or controlled by the other or if more than 50 percent of the voting stock

of both is directly or indirectly owned or controlled by the same interest.

(d) The information return shall identify the corporate parent and those affiliates of which more than 20 percent of the voting stock is directly or indirectly owned or controlled by the parent. The information return shall identify the percentage of ownership and the type of corporation (foreign organized, United States organized, Foreign Sales Corporation, or other relevant descriptions).

(e) If the taxpayer willfully fails to substantially comply with this section, the taxpayer shall be subject to the penalty described in subdivision (d) of Section 19141.6.

(f) This section shall not apply to any bank or corporation with regard to any year if that bank's or corporation's payroll, property, and sales within the United States are each less than five hundred thousand dollars (\$ 500,000).

....

SEC. 16. Section 19141.6 is added to the Revenue and Taxation Code, to read:

19141.6. (a) Each taxpayer determining its income subject to tax pursuant to Section 25101 or electing to file pursuant to Section 25110 shall, for income years beginning on or after January 1, 1994, maintain (in the location, in the manner, and to the extent prescribed in regulations which shall be promulgated by the Franchise Tax Board on or before December 31, 1995) and make available upon request all of the following:

(1) Any records as may be appropriate to determine the correct treatment of the components that are a part of one or more unitary businesses for purposes of determining the income derived from or attributable to this state pursuant to Section 25101 or 25110.

(2) Any records as may be appropriate to determine the correct treatment of amounts that are attributable to the classification of an item as business or nonbusiness income for purposes of Article 2 (commencing with Section 25120) of Chapter 17 of Part 11.

(3) Any records as may be appropriate to determine the correct treatment of the apportionment factors for purposes of Article 2 (commencing with Section 25120) of Chapter 17 of Part 11.

(4) Documents and information, including any questionnaires completed and submitted to the Internal Revenue Service that are necessary to audit issues involving attribution of income to the United States or foreign jurisdictions under Section 882 and Subpart F of Part III of Subchapter N, or similar sections, of the Internal Revenue Code.

(b) For purposes of this section:

(1) Information for any year shall be retained for that period of time in which the taxpayers' income or franchise tax liability to this state may be subject to adjustment, including all periods in which additional income or franchise taxes may be assessed, not to exceed eight years from the due date or extended due date of the return, or during which a protest is pending before the Franchise Tax Board, or an appeal is pending before the

State Board of Equalization or a lawsuit is pending in the courts of this state or the United States with respect to California franchise or income tax.

(2) "Related party" means banks and corporations that are related because one owns or controls directly or indirectly more than 50 percent of the stock of the other or because more than 50 percent of the voting stock of each is owned or controlled, directly or indirectly, by the same interests.

(3) "Records" includes any books, papers, or other data.

(c)(1) If a bank or corporation subject to this section fails to maintain or fails to cause another to maintain records as required by subdivision (a), or willfully fails to comply substantially with Section 18634 requiring the filing of an information return, that bank or corporation shall pay a penalty of ten thousand dollars (\$ 10,000) for each income year with respect to which the failure occurs.

(2) If any failure described in paragraph (1) continues for more than 90 days after the day on which the Franchise Tax Board mails notice of the failure to the bank or corporation, that bank or corporation shall pay a penalty (in addition to the amount required under paragraph (1)) of ten thousand dollars (\$ 10,000) for each 30-day period (or fraction thereof) during which the failure continues after the expiration of the 90-day period. The additional penalty imposed by this subdivision shall not exceed a maximum of fifty thousand dollars (\$ 50,000) if the failure to maintain or the failure to cause another to maintain is not willful. This maximum shall apply with respect to income years beginning on or after January 1,

1994, and before the earlier of the first day of the month following the month in which regulations are adopted pursuant to this section or December 31, 1995.

(3) For purposes of this section, the time prescribed by regulations to maintain records (and the beginning of the 90-day period after notice by the Franchise Tax Board) shall be treated as not earlier than the last day on which (as shown to the satisfaction of the Franchise Tax Board) reasonable cause existed for failure to maintain the records.

(d) (1) The Franchise Tax Board may apply the rules of paragraph (2) whether or not the board begins a proceeding to enforce a subpoena, or subpoena duces tecum, if subparagraph (A), (B), and (C) apply:

(A) For purposes of determining the correct treatment under Part 11 (commencing with Section 23001) of the items described in subdivision (a), the Franchise Tax Board issues a subpoena or subpoena duces tecum to a bank or corporation to produce (either directly or as agent for the related party) any records or testimony.

(B) The subpoena or subpoena duces tecum is not quashed in a proceeding begun under paragraph (3) and is not determined to be invalid in a proceeding begun under Section 19504 to enforce the subpoena.

(C) The bank or corporation does not substantially comply in a timely manner with the subpoena or subpoena duces tecum and the Franchise Tax Board has sent by certified or registered mail a notice to that bank or corporation that it has not substantially complied.

(D) If the bank or corporation fails to maintain or fails to cause another to maintain records as required by subdivision (a), and by reason of that failure, the subpoena, or subpoena duces tecum, is quashed in a proceeding described in subparagraph (B) or the bank or corporation is not able to provide the records requested in the subpoena or subpoena duces tecum, the Franchise Tax Board may apply the rules of paragraph (2) to any of the items described in subdivision (a) to which the records relate.

(2) (A) All of the following shall be determined by the Franchise Tax Board in the Franchise Tax Board's sole discretion from the Franchise Tax Board's own knowledge or from the information as the Franchise Tax Board may obtain through testimony or otherwise:

(i) The components that are a part of one or more unitary businesses for purposes of determining the income derived from or attributable to this state pursuant to Section 25101 or 25110.

(ii) Amounts that are attributable to the classification of an item as business or nonbusiness income for purposes of Article 2 (commencing with Section 25120) of Chapter 17 of Part 11.

(iii) The apportionment factors for purposes of Article 2 (commencing with Section 25120) of Chapter 17 of Part 11.

(iv) The correct amount of income under Section 882 of Subpart F of the Internal Revenue Code, or similar sections of the Internal Revenue Code.

(B) This paragraph shall apply to determine the correct treatment of the items described in subdivision (a) unless the bank or corporation is authorized by its related parties (in the manner and at the time as the Franchise Tax Board shall prescribe) to act as the related parties' limited agent solely for purposes of applying Section 19504 with respect to any request by the Franchise Tax Board to examine records or produce testimony related to any item described in subdivision (a) or with respect to any subpoena or subpoena duces tecum for the records or testimony. The appearance of persons or the production of records by reason of the bank or corporation being an agent shall not subject those persons or records to legal process for any purpose other than determining the correct treatment under Part 11 of the items described in subdivision (a).

(3) (A) Notwithstanding any other law or rule of law, any reporting bank or corporation to which the Franchise Tax Board issues a subpoena or subpoena duces tecum referred to in subparagraph (A) of paragraph (1) shall have the right to begin a proceeding to quash the subpoena not later than the 90th day after the subpoena was issued. In that proceeding, the Franchise Tax Board may seek to compel compliance with the subpoena.

(B) Notwithstanding any other law or rule of law, any reporting bank or corporation that has been notified by the Franchise Tax Board that it has determined that the bank or corporation has not substantially complied with a subpoena or subpoena duces tecum referred to in paragraph (1) shall have the right to begin a proceeding to review the determination not later than the 90th day after

the day on which the notice referred to in subparagraph (C) of paragraph (1) was mailed. If the proceeding is not begun on or before the 90th day, the determination by the Franchise Tax Board shall be binding and shall not be reviewed by any court.

(C) The superior courts of the State of California for the Counties of Los Angeles, Sacramento, and San Diego, and for the City and County of San Francisco shall have jurisdiction to hear any proceeding brought under subparagraphs (A) and (B). Any order or other determination in the proceeding shall be treated as a final order that may be appealed.

(D) If any bank or corporation takes any action as provided in subparagraphs (A) and (B), the running of any period of limitations under Sections 19057 to 19064, inclusive (relating to the assessment and collection of tax), or under Section 19704 (relating to criminal prosecutions) with respect to that bank or corporation shall be suspended for the period during which the proceedings, and appeals therein, are pending. In no event shall any period expire before the 90th day after the day on which there is a final determination in the proceeding.

SEC. 22. Section 25110 of the Revenue and Taxation Code, as amended by Chapter 31 of the Statutes of 1993, is amended to read:

25110. (a) Notwithstanding Section 25101, a qualified taxpayer, as defined in paragraph (2) of subdivision (b) which is subject to the tax imposed under this part, may elect, subject to the provisions of Section 25111, to

account for and determine its income derived from or attributable to sources within this state pursuant to a water's-edge election in accordance with the provisions of this part, as modified by this article. A taxpayer which makes that water's-edge election shall take into account the income and apportionment factors of the following affiliated entities only:

(1) Affiliated banks or corporations which are eligible to be included in a federal consolidated return as described in Sections 1501 to 1505, inclusive, of the Internal Revenue Code, other than corporations making an election under Section 936 of the Internal Revenue Code.

(2) Domestic international sales corporations, as described in Sections 991 to 994, inclusive, of the Internal Revenue Code and foreign sales corporations as described in Sections 921 to 927, inclusive, of the Internal Revenue Code.

(3) Any corporation, regardless of the place where it is incorporated if the average of its property, payroll, and sales factors within the United States is 20 percent or more.

(4) Banks and corporations which are incorporated in the United States, excluding corporations making an election pursuant to Sections 931 to 936, inclusive, of the Internal Revenue Code, of which more than 50 percent of their stock is controlled directly or indirectly by the same interests, which are not included in paragraph (1).

(5) A bank or corporation which is not described in paragraphs (1) to (4), inclusive, or paragraph (6), but only to the extent of its income derived from or attributable to

sources within the United States and its factors assignable to a location within the United States in accordance with paragraph (3) of subdivision (b). Income of such a bank or corporation derived from or attributable to sources within the United States as determined by federal income tax laws shall be limited to and determined from the books of account maintained by the bank or corporation with respect to its activities conducted within the United States.

(6) Export trade corporations, as described in Sections 970 to 972, inclusive, of the Internal Revenue Code.

(7) Any affiliated bank or corporation which is a "controlled foreign corporation," as defined in Section 957 of the Internal Revenue Code, if all or part of the income of that affiliate is defined in Section 952 of Subpart F of the Internal Revenue Code ("Subpart F income"). The income and apportionment factors of any affiliate to be included under this paragraph shall be determined by multiplying the income and apportionment factors of that affiliate without application of this paragraph by a fraction (not to exceed one), the numerator of which is the "Subpart F income" of that bank or corporation for that income year and the denominator of which is the "earnings and profits" of that bank or corporation for that income year, as defined in Section 964 of the Internal Revenue Code.

(8) (A) The income and factors of the above-enumerated banks and corporations shall be taken into account only if the income and factors would have been taken into account under Section 25101 if this section had not been enacted.

(B) The income and factors of a bank or corporation which is not described in paragraphs (1) to (4), inclusive, and (6) and which is an electing taxpayer under this subdivision shall be taken into account in determining its income only to the extent set forth in paragraph (5).

(b) For purposes of this article and Section 24411:

(1) An "affiliated bank or corporation" means a bank or corporation which is related to a bank or corporation, required to file under this part, because of any of the following:

(A) It owns directly or indirectly more than 50 percent of the voting stock of the bank or corporation required to file under this part.

(B) More than 50 percent of its voting stock is owned directly or indirectly by a bank or corporation required to file under this part.

(C) More than 50 percent of voting stock of both it and the bank or corporation required to file under this part is owned or controlled directly or indirectly by any bank or person (as defined in Section 7701(a)(1) of the Internal Revenue Code).

(2) A "qualified taxpayer" means a bank or corporation which does both of the following:

(A) Files with the state tax return on which the water's-edge election is made a consent to the taking of depositions at the time and place most reasonably convenient to all parties from key domestic corporate individuals and to the acceptance of subpoenas duces tecum requiring reasonable production of documents to the Franchise Tax Board as provided in Section 19504 or by

the State Board of Equalization as provided in Title 18, California Code of Regulations, Section 5005, or by the courts of this state as provided in Chapter 2 (commencing with Section 1985) of Title 3 of Part 4 of, and Section 2025 of, the Code of Civil Procedure. The consent relates to issues of jurisdiction and service and does not waive any defenses a taxpayer may otherwise have. The consent shall remain in effect so long as the water's-edge election is in effect and shall be limited to providing that information necessary to review or to adjust income or deductions in a manner authorized under Sections 482, 861, Subpart F of Part III of Subchapter N, or similar provisions of the Internal Revenue Code, together with the regulations adopted pursuant to those provisions, and for the conduct of an investigation with respect to any unitary business in which the taxpayer may be involved.

(B) Agrees that for purposes of this article, dividends received by any bank or corporation whose income and apportionment factors are taken into account pursuant to subdivision (a) from either of the following are functionally related dividends and shall be presumed to be business income:

(i) A bank or corporation of which more than 50 percent of the voting stock is owned, directly or indirectly, by members of the unitary group and which is engaged in the same general line of business.

(ii) Any bank or corporation which is either a significant source of supply for the unitary business or a significant purchaser of the output of the unitary business, or which sells a significant part of its output or obtains a significant part of its raw materials or input

from the unitary business. "Significant," as used in this subparagraph, means an amount of 15 percent or more of either input or output.

All other dividends shall be classified as business or nonbusiness income without regard to this subparagraph.

(3) The definitions and locations of property, payroll, and sales shall be determined under the laws and regulations which set forth the apportionment formulas used by the individual states to assign net income subject to taxes on or measured by net income in that state. If a state does not impose a tax on or measured by net income or does not have laws or regulations with respect to the assignment of property, payroll, and sales, the laws and regulations provided in Article 2 (commencing with Section 25120) shall apply.

Sales shall be considered to be made to a state only if the bank or corporation making the sale may otherwise be subject to a tax on or measured by net income under the Constitution or laws of the United States, and shall not include sales made to a bank or corporation whose income and apportionment factors are taken into account pursuant to subdivision (a) in determining the amount of income of the taxpayer derived from or attributable to sources within this state.

(4) "The United States" means the 50 states of the United States and the District of Columbia.

(c) All references in this part to income determined pursuant to Section 25101 shall also mean income determined pursuant to this section.

SEC. 23. Section 25111 of the Revenue and Taxation Code, as amended by Chapter 31 of the Statutes of 1993, is amended to read:

25111. (a) The making of a water's-edge election as provided for in Section 25110 shall be made by contract with the Franchise Tax Board in the original return for a year and shall be effective only if every taxpayer which is a member of the water's-edge group and which is subject to tax under this part makes the election. A single taxpayer which is engaged in more than one business activity subject to allocation and apportionment as provided in Article 2 (commencing with Section 25120) of Chapter 17 may make a separate election for each business. The form and manner of making the water's-edge election shall be prescribed by the Franchise Tax Board. Each contract making a water's-edge election shall be for an initial term of 84 months, except as provided in subdivisions (b). Each contract shall provide that on the anniversary date of the contract or any other annual date specified by the contract a year shall be added automatically to the initial term unless notice of nonrenewal is given as provided in subdivision (d). An affiliated bank or corporation which is a member of the water's-edge group and subsequently becomes subject to tax under this part or is a nonelecting taxpayer which is subsequently proved to be a member of the water's-edge group pursuant to Franchise Tax Board audit determination, as evidenced by a notice of deficiency proposed to be assessed or a notice of tax change, shall be deemed to have elected.

No water's-edge election shall be made for an income year beginning prior to January 1, 1988.

(b) A water's-edge election may be terminated by a taxpayer prior to the end of the 84-month period if either of the following occurs:

(1) The taxpayer is acquired directly or indirectly by a nonelecting entity which alone or together with those affiliates included in its combined report is larger than the taxpayer as measured by equity capital.

(2) With the permission of the Franchise Tax Board.

(c) In granting a change of election, the Franchise Tax Board shall impose any conditions which are necessary to prevent the avoidance of tax or clearly reflect income for the period the election was, or was purported to be, in effect. These conditions may include a requirement that income, including dividends paid from income earned while a water's-edge election was in effect, which would have been included in determining the income of the taxpayer from sources within and without this state pursuant to Section 25101 but for the water's-edge election shall be included in income in the year in which the election is changed.

(d) If the taxpayer desires in any year not to renew the election, the taxpayer shall serve written notice of nonrenewal upon the board at least 90 days in advance of the annual renewal date. Unless that written notice is provided to the board, the election shall be considered renewed as provided in subdivision (a).

(e) If the taxpayer serves notice of intent in any year not to renew the existing water's-edge election, that existing election shall remain in effect for the balance of the

period remaining since the original election or the last renewal of the election, as the case may be.

SEC. 24. Section 25111.1 is added to the Revenue and Taxation Code, to read:

25111.1. For any income year beginning on or after January 1, 1994, consideration for water's-edge contracts in existence as of that date is no longer provided for by law. Those contracts are rescinded for any periods remaining on the contracts commencing on the first day of the taxpayer's income year that begins on or after January 1, 1994. Any fiscal year taxpayer whose contract is in effect as of December 31, 1993, shall continue to be bound by that contract until the close of its income year after January 1, 1994, and before December 31, 1994.

SEC. 25. Section 25112 of the Revenue and Taxation Code, as amended by Chapter 31 of the Statutes of 1993, is amended to read:

25112. (a) If a taxpayer electing to file under Section 25110 fails to supply any information described in subdivision (b), the taxpayer shall pay a penalty of one thousand dollars (\$ 1,000) for each income year with respect to which the failure occurs.

(b) A taxpayer electing pursuant to Section 25110 shall do all of the following:

(1) Retain and make available upon request the documents and information, including any questionnaires completed and submitted to the Internal Revenue Service or qualified states, which are necessary to audit issues involving attribution of income to the United States or foreign jurisdictions under Sections 482, 861, 863, 902,

and 904, and Subpart F of Part III of Subchapter N, or similar sections of the Internal Revenue Code.

(2) Identify, upon request, principal officers or employees who have substantial knowledge of, and access to, documents and records which discuss pricing policies, profit centers, cost centers, and the methods of allocating income and expense among these centers. The information shall include the employees' titles and addresses.

(3) Retain and make available upon request all documents and correspondence ordinarily available to a bank or corporation included in the water's-edge election which are submitted to, or obtained from, the Internal Revenue Service, foreign countries or their territories or possessions, and competent authority pertaining to ruling requests, rulings, settlement resolutions, and competing claims involving jurisdictional assignment and sourcing of income that affect the assignment of income to the United States. The documents shall include all ruling requests and rulings on reorganizations involving foreign incorporation of branches, all ruling requests and rulings on changing a bank or corporation's jurisdictional incorporation, and all documents which are ordinarily available to a bank or corporation included in the water's-edge election which pertain to the determination of foreign tax liability, including examination reports issued by foreign taxing administrations. If the documents have been translated, the translations shall be furnished.

(4) Upon request, prepare and make available for each bank or corporation included in the information return referred to in Section 18634 in which the taxpayer

is included, a list of each state of the United States, including the District of Columbia, territories or possessions, and each foreign country in which it has payroll, property, or sales. The sales shall be determined by destination whether or not the taxpayer is taxable in the destination jurisdiction.

(5) Retain and make available, upon request, information filed with the Internal Revenue Service to comply with Sections 6038, 6038A, 6038B, 6038C, and 6041 of the Internal Revenue Code.

(6) Upon request, prepare and make available for each bank or corporation organized or created under the laws of the United States or a political subdivision thereof, of which 50 percent or more of its voting stock is directly or indirectly owned or controlled, the information which would be included in the forms described in paragraph (5) if those forms were required for United States corporations.

(7) Retain and make available, upon request, all state tax returns filed by each bank or corporation included under subdivision (a) in each state, including the District of Columbia.

(8) Comply with reasonable requests for information necessary to determine or verify its net income, apportionment factors, or the geographic source of that income pursuant to the Internal Revenue Code.

(9) For purposes of this subdivision, information for any year shall be retained for that period of time in which the taxpayer's income or franchise tax liability to this state may be subject to adjustment, including all periods

in which additional income or franchise taxes may be assessed or during which an appeal is pending before the State Board of Equalization or a lawsuit is pending in the courts of this state or the United States with respect to California franchise or income tax.

(c) If the failure continues for more than 90 days after the date on which the Franchise Tax Board mails notice of that failure to the taxpayer, the taxpayer shall pay a penalty (in addition to the amount required under subdivision (a)) of one thousand dollars (\$ 1,000) for each 30-day period (or fraction thereof) during which the failure continues after the expiration of the 90-day period. The increase in any penalty under this subdivision shall not exceed twenty-four thousand dollars (\$ 24,000).

(d) If the taxpayer fails to comply substantially with any formal document request arising out of the examination of the tax treatment of any item (hereinafter in this section referred to as the "examined item") before the 90th day after the date of the mailing of the request, any court having jurisdiction of a civil proceeding in which the tax treatment of the examined item is an issue may, upon motion by the Franchise Tax Board, prohibit the introduction by the taxpayer of documentation covered by that request.

(e) For purposes of this section, the time in which information is to be furnished (and the beginning of the 90-day period after notice by the Franchise Tax Board) shall be treated as beginning not earlier than the last day on which reasonable cause existed for failure to furnish the information.

(f) This section shall not apply with respect to any requested documentation if the taxpayer establishes that the failure to provide the documentation, as requested by the Franchise Tax Board, is due to reasonable cause. For purposes of subdivision (d), the fact that a foreign jurisdiction would impose a civil or criminal penalty on the taxpayer (or any other person) for disclosing the requested documentation is not reasonable cause unless, after in-camera review of the documentation, the court finds otherwise.

(g) For purposes of this section, the term "formal document request" means any request (made after the normal request procedures have failed to produce the requested documentation) for the production of documentation which is mailed by registered or certified mail to the taxpayer at its last known address and which sets forth all of the following:

- (1) The time and place for the production of the documentation.
- (2) A statement of the reason the documentation previously produced (if any) is not sufficient.
- (3) A description of the documentation being sought.
- (4) The consequences to the taxpayer of the failure to produce the documentation described in this section.

(h) Notwithstanding any other law or rule of law, any taxpayer to whom a formal document request is mailed may begin a proceeding to quash that request not later than the 90th day after the date the request was

mailed. In any such proceeding, the Franchise Tax Board may seek to compel compliance with the request.

(i) The superior courts of the State of California for the Counties of Los Angeles, Sacramento, and San Diego, and for the City and County of San Francisco shall have jurisdiction to hear any proceeding brought under subdivision (h). An order denying the petition shall be deemed a final order which may be appealed.

The running of the 90-day period referred to in subdivision (c) shall be suspended during any period during which a proceeding brought under subdivision (h) is pending.

(j) For purposes of this section, "documentation" means any documentation which may be relevant or material to the tax treatment of the examined item.

(k) The Franchise Tax Board, and any court having jurisdiction over a proceeding under subdivision (g), may extend the 90-day period referred to in subdivision (b).

(l) If any bank or corporation takes any action as provided in subdivision (h), the running of any period of limitations under Sections 19057 to 19067, inclusive (relating to the assessment and collection of tax), or under Section 19704 (relating to criminal prosecutions) with respect to that bank or corporation shall be suspended for the period during which the proceedings under subdivision (h) and appeals thereto are pending.

SEC. 26. Section 25115 of the Revenue and Taxation Code is amended to read:

25115. (a) For income years beginning before January 1, 1994, each contract described in Section 25111 shall

provide that a taxpayer making a water's-edge election pursuant to this article shall pay an annual amount to the Franchise Tax Board for deposit in the California Unitary Fund created pursuant to Section 16429.30 of the Government Code. One-third of the amount shall be deposited in the Local Project Account for Non-Transient Spending in the California Unitary Fund, and two-thirds of the amount shall be deposited in the Future Infrastructure State Targeted Account in the California Unitary Fund.

(b) The amount shall be equal to thirty-thousandths of 1 percent of the sum of the taxpayer's property and payroll assigned to this state for an income year of 12 full months ending during the calendar year 1986 and its sales assigned to this state for the current income year. A single corporation which is engaged in more than one business for which it is making separate elections shall determine the amount as provided in this section for each business for which it is electing to determine its income pursuant to Section 25110.

(c) The sum of the property, payroll, and sales, as calculated pursuant to subdivision (b) shall be reduced by the cumulative amount expended since January 1, 1987, for investment in new plants or facilities in this state, as defined in subdivision (d), and shall further be reduced by the amount expended for new employees in this state as defined in subdivision (f).

(d) A new plant or facility is property described in Section 70, constructed by or for the taxpayer, or new tangible personal property, the original use of which commences with the taxpayer in this state, provided that it is not a replacement, in whole or in part, for an existing

plant or facility in this state. For purposes of this subdivision, "new tangible personal property" means the current year's acquisition of personal property classified as "machinery and equipment for industry, profession, or trade," "tools, molds, dies, jigs," and "computers and related equipment," as reported to either the county assessor pursuant to Section 441 or the State Board of Equalization pursuant to Section 826. A plant or facility shall be deemed a replacement if the taxpayer, or an affiliated bank or corporation, as defined in paragraph (1) of subdivision (b) of Section 25110, closes, takes out of service, sells, or leases to an unrelated party, in either the three immediately preceding or the three immediately succeeding years from the time the new plant or facility is operational, a plant or facility with a cost basis equal to 25 percent or more of the cost basis of the new plant or facility.

(e) The number of new employees in this state for any income year shall be determined by comparing the total number of work years in this state for the income year to the greater of (1) the average of the total number of work years in this state for the income years ending in 1985, 1986, and 1987, or (2) the total number of work years in this state for the income year ending in 1987. A "work year" means, in the case of workers who are paid an hourly wage, 2,000 paid hours, and in the case of salaried employees, a total of 12 paid months.

(f) The amount expended for new employees shall be equal to the product of the number of new employees determined pursuant to subdivision (e) and the average wages paid for each work year in this state for the income year.

(g) Each contract shall provide that the amount described in this section shall not be subject to any statutory changes, for the period the contract is in effect, without the consent of the taxpayer. Any statutory change shall be applicable for any renewal year beginning five years after that statutory change.

(h) Amounts determined pursuant to this section shall be collected and refunded in the same manner as the taxes imposed by this part and shall be subject to interest and penalties as provided in this part.

(i) In no event shall the amount determined pursuant to this section be less than ten-thousandths of 1 percent of the sum of the taxpayer's property, payroll, and sales in this state for the current year.

(j) For purposes of this section, the bank's or corporation's property, payroll, and sales in this state shall be determined pursuant to Article 2 (commencing with Section 25120) of Chapter 17, and regulations adopted pursuant thereto, except that both of the following shall apply:

(1) Property shall include only property defined in Sections 25129 to 25131, inclusive.

(2) Sales shall not include gross receipts from the sale of real property and improvements thereto and the sale of the stock of a subsidiary unless that activity occurs as a regular part of the taxpayer's business.

(k) The annual amount otherwise determined pursuant to this section and payable under a contract described in Section 25111 shall not be imposed for an

income year in which a taxpayer incurs no tax liability under Sections 25101 and 25110.

(l) If a taxpayer is reorganized into two or more separate entities, the 1986 property and payroll factors for the new entities shall be determined by the ratio of current property and payroll factors, excluding intangible property, for each new entity subject to tax in California to the total for all entities subject to tax in California for the year in which those entities are created. This ratio shall be applied to 1986 property and payroll and each entity shall be allocated a portion of the 1986 payments and payroll based on this ratio.

(m) Notwithstanding Section 24345, the amount imposed by this section shall be allowed as a deduction in computing the taxes imposed by this part.

(n) This section shall remain in effect until January 1, 1994, and as of that date is repealed.

SEC. 34. This act provides for a tax levy within the meaning of Article IV of the Constitution and shall go into immediate effect. However, except as provided in Section 27, the provisions of this act shall become operative on January 1, 1994, and shall be applied in the computation of taxes for income years beginning on or after January 1, 1994.
